

Yield curve control and the exit

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Abstract

Japan's cap on the ten-year yield, Australia's failed three-year target, quantitative tightening, and what the 2019 repo spike taught about how far balance sheets can shrink.

Two questions close the toolkit. Can a central bank target long rates directly instead of buying a quantity and hoping? And how does it get out once the emergency is over?

Yield curve control

In September 2016 the Bank of Japan announced that it would hold the ten-year government bond yield at “around zero percent”, buying whatever quantity was needed, alongside a short rate of minus 0.1 percent (Bank of Japan, 2016). This is **yield curve control**: a price target rather than a quantity target.

Definition 1 (Yield curve control). A commitment to buy (or sell) government bonds in whatever amount keeps a chosen maturity's yield at or within a band around a target level. The instrument is the price; the balance sheet becomes an outcome.

The appeal is that a credible target requires *fewer* purchases: if markets believe the cap, they price the bond at the cap and the central bank rarely has to buy. The Bank of Japan's purchases indeed slowed after 2016. The risks are the mirror image. A cap that markets stop believing has to be defended with unlimited purchases; a cap on one maturity distorts the curve around it; and the exit requires either an announcement that moves the yield in a jump or a slow widening of the band during which the central bank is visibly fighting the market.

Japan chose the slow route. The band was widened in December 2022 to plus or minus 0.5 percent, loosened further in 2023, and the framework, together with the negative short rate, ended in March 2024. The transition was orderly, and the ten-year yield rose gradually to around 1 percent.

Australia's counter-example

The Reserve Bank of Australia targeted the three-year yield from March 2020, first at 0.25 and then at 0.10 percent, tied to a statement that the cash rate was not expected to rise before 2024. In late October 2021, as inflation data surprised upward, the three-year yield broke above the target and the bank did not defend it; the target was formally abandoned on 2 November 2021. The bank's own review concluded that the exit had been disorderly, that the target had become inconsistent with the outlook well before it was dropped, and that the reputational damage was real (Reserve Bank of Australia, 2022). The lesson: a yield target is a promise, and its credibility is the whole instrument. Choosing a maturity short enough to be consistent with plausible policy paths, and a clear exit condition, would have avoided most of the damage.

Quantitative tightening

Shrinking the balance sheet is called quantitative tightening (QT). The Fed did it twice: from October 2017 to September 2019 with monthly caps on maturing securities not reinvested, and from June 2022 with caps of 60 billion dollars of Treasuries and 35 billion of mortgage-backed securities a month, slowed in 2024 and 2025

and concluded in December 2025. The ECB stopped reinvesting maturing bonds from its main programme in mid-2023 and from the pandemic programme by the end of 2024.

Three features of QT differ from QE in reverse.

- **It is passive.** Letting bonds mature avoids the announcement effects of sales, so its yield effect is smaller per unit than QE's; central banks describe it as running "in the background".
- **The constraint is reserves, not bonds.** QT drains reserves. At some level banks' demand for reserves, driven by liquidity regulation and payment needs, is no longer satisfied, and money-market rates jump.
- **The floor can crack.** On 17 September 2019 the US overnight repo rate spiked to several times the policy rate as reserves, drained by two years of QT and by a corporate tax date, proved insufficient. The Fed restarted bill purchases within weeks. The episode set a practical lower limit on reserves and is why the second QT was slowed as reserves approached what the Fed judged "ample" rather than scarce.

Sequencing the exit

The consensus sequence that emerged from 2015–2019 and again after 2021: end net purchases, then raise the policy rate, then start passive QT, with the balance sheet as the last and slowest lever. The order reflects the tools' precision: the policy rate is a well-understood instrument, the balance sheet is not, so it is moved last and slowly. The 2022 exit compressed the sequence, ending purchases and beginning rate rises within the same quarter, because inflation left no room for the leisurely version.

The next lesson, Lessons and open questions, asks whether the exit shows that the tools were used for too long.

Bank of Japan. (2016). *New framework for strengthening monetary easing: "Quantitative and qualitative monetary easing with yield curve control"*. Statement on monetary policy, 21 September. https://www.boj.or.jp/en/mopo/mpmdeci/mpr_2016/k160921a.pdf

Reserve Bank of Australia. (2022). *Review of the yield target*. Reserve Bank of Australia. <https://www.rba.gov.au/monetary-policy/reviews/yield-target/>